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## Islands in the stream – Why mutual

# cooperation is necessary in the Irish sovereign crisis

Dr Geeta Lakshmi, Senior Lecturer in Finance, Lincoln Business School: Countries like companies are going bust these days. The global system is so intertwined that systemic shocks affect countries like ninepins. Some time ago it was specific risks and debt mismanagement which afflicted countries but currently it is systemic risk which has taken precedent. Like [...]

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***Dr Geeta Lakshmi, Senior Lecturer in Finance, Lincoln Business School:***

Countries like companies are going bust these days. The global system is so intertwined that systemic shocks affect countries like ninepins. Some time ago it was specific risks and debt mismanagement which afflicted countries but currently it is systemic risk which has taken precedent. Like the oil shock of the seventies, it is now the banks that have become the new grenade which is exploding in the front rooms of European countries like Ireland.

## **Banking system**

What does this tell us about the nature of the banking system? The banking

system has evolved dramatically in the last thirty years and key contributors to the change have been conversion in government stance and deregulation, technology and globalisation. The results of the replacements have been a “democratization of credit” and concurrently securitization of debt.

Everyone it seems is entitled to borrow money, a norm we have stretched too far. Governments have been as responsible for this phenomenon, as corporate bodies, as management of the economy through fiscal policies languished in the last two decades in favour of using monetary policies as a tool.

The banks have been quick to bundle the credit on their books and sell it off to other banks. The ownership and ultimate liability of the owner is thus mercurial enough to vanish like quick silver. The failure of the accounting profession to keep up with this is a matter of concern. After all, countries are like companies and they must follow the same market and accountability discipline.

## **Diversification**

So what can we do to protect ourselves in the future? There needs to be a reform of the banking sector so that the fundamental risks do not travel to the heart of the system. Also, the production base of the economy needs to be diversified enough to withstand the cost of risks to one sector. People forget that risks are double-edged: what goes up can (and usually does) also come down.

The accounting profession must also develop the use of accounting tools to

better reflect the conditions within a country. Currently, it is the annual Balance of Payments which is put under scrutiny and few indicators are available on a more frequent basis. Debt management is about good accounting and information should be speedily available instead of publishing annual figures of external debt.

## **Repudiation and penalties**

What can countries do to impose penalties? Trade sanctions and wars, taxes and quotas are all examples of such situations. A more interesting example is the threat of nudging other countries' favourable internal policies which may give them a competitive edge. Ireland's fiscal policy of low corporate taxation was a sitting duck. Fortunately, the word is that it is to remain untouched.

## **Mutual cooperation**

What lenders sometimes forget (as in the case of the American homeowners' loan) is that lending is not a zero sum game and the prosperity of the borrower is paramount to the prosperity of the lender.

In an open system, countries are responsible not only for themselves but also for the collective actions of their neighbours due to economic risk. Therefore bail-out may be a matter of shame for the Irish but is also of concern to its neighbours.

George Osborne is right to offer help to Ireland despite our non entry in the Euro-zone. In the spirit of the Gibb brothers who wrote the popular lyrics of “Islands in the stream” song, we really can’t live without each other. In the open, global system there are many islands but we constantly need each other. It is not only the civilised thing to do, it happens to be the essential economic thing to do.

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